

**LEMON GROVE  
COMMUNITY DEVELOPMENT AGENCY**

**BASIC FINANCIAL STATEMENTS**

**JUNE 30, 2006**



**LEMON GROVE COMMUNITY DEVELOPMENT AGENCY**  
**Basic Financial Statements**  
**June 30, 2006**

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## INDEPENDENT AUDITOR'S REPORT

Board of Directors  
Lemon Grove Community Development Agency  
Lemon Grove, California

We have audited the accompanying financial statements of the governmental activities and each major fund of the Lemon Grove Community Development Agency (Agency), a component unit of the City of Lemon Grove, California, as of and for the fiscal year ended June 30, 2006, which collectively comprise the Agency's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Agency's management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance as to whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities and each major fund of the Lemon Grove Community Development Agency as of June 30, 2006, and the respective changes in the financial position thereof, and the respective budgetary comparison for the Housing Set-Aside Fund for the fiscal year then ended, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1 of the notes to the basic financial statements, the Agency adopted Governmental Accounting Standards Board Statement No. 46, Net Assets Restricted by Enabling Legislation, effective July 1, 2005.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 19, 2006, on our consideration of the Agency's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal

control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The Lemon Grove Community Development Agency has not presented management's discussion and analysis that the Governmental Accounting Standards Board has determined is necessary to supplement, although not required to be part of, the basic financial statements.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Agency's basic financial statements. The accompanying budgetary comparison schedules for the Capital Projects Fund and the Debt Service Fund listed in the table of contents are presented for purposes of additional analysis and are not a required part of the basic financial statements. The budgetary comparison schedules of the Capital Projects Fund and the Debt Service Fund have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

*Moss, Levy & Hartzheim*

Moss, Levy & Hartzheim, LLP  
Beverly Hills, California  
October 19, 2006

**LEMON GROVE COMMUNITY DEVELOPMENT AGENCY**  
**STATEMENT OF NET ASSETS**  
**June 30, 2006**

**ASSETS**

	Governmental Activities
Cash and investments	\$ 7,840,451
Cash and investments with fiscal agent	1,069,479
Accounts receivable	96,402
Tax increment receivable	33,731
Interest receivable	20,225
Notes receivable	182,491
Deferred charges - net of accumulated amortization	825,599
	<hr/>
Total Assets	10,068,378
	<hr/>

**LIABILITIES**

Accounts payable and accrued liabilities	7,591
Interest payable	330,697
Deposit payable	25,000
Long-term debt:	
Due in one year	345,000
Due in more than one year	18,730,042
	<hr/>
Total Liabilities	19,438,330
	<hr/>

**NET ASSETS**

Restricted for:	
Debt service	1,732,248
Low and moderate income housing	4,017,948
	<hr/>
Total restricted net assets	5,750,196
Unrestricted	<hr/>
	(15,120,148)
	<hr/>
Total Net Assets (Deficit)	\$ (9,369,952)
	<hr/>

See accompanying notes to basic financial statements

**LEMON GROVE COMMUNITY DEVELOPMENT AGENCY**  
**STATEMENT OF ACTIVITIES**  
**FOR THE FISCAL YEAR ENDED JUNE 30, 2006**

	<u>Expenses</u>	<u>Net (Expense) Revenue and Change in Net Assets</u>
Governmental Activities		
Expenses:		
Community development	\$ (395,276)	\$ (395,276)
Pass-through payments	(324,019)	(324,019)
Interest on long-term debt	(992,708)	(992,708)
	<u>                    </u>	<u>                    </u>
Total	<u>\$ (1,712,003)</u>	<u>(1,712,003)</u>
General Revenues:		
Taxes:		
Incremental property taxes		2,312,154
Use of money and property		323,263
Other revenue		4,803
		<u>                    </u>
Total General Revenues		<u>2,640,220</u>
Change in Net Assets		928,217
Net Assets (Deficit) - Beginning of fiscal year		<u>(10,298,169)</u>
Net Assets (Deficit) - End of fiscal year		<u>\$ (9,369,952)</u>

See accompanying notes to basic financial statements



**LEMON GROVE COMMUNITY DEVELOPMENT AGENCY**  
**BALANCE SHEET**  
**GOVERNMENTAL FUNDS**  
**June 30, 2006**

	Housing Set-Aside Fund	Capital Projects Fund	Debt Service Fund	Totals
<b>ASSETS</b>				
Cash and investments	\$ 3,754,242	\$ 3,081,908	\$ 1,004,301	\$ 7,840,451
Cash and investments with fiscal agent		18	1,069,461	1,069,479
Accounts receivable	4,803	35,211	56,388	96,402
Tax increment receivable	33,731			33,731
Interest receivable	20,225			20,225
Due from other funds	24,840	42,365		67,205
Notes receivable	182,491			182,491
<b>Total Assets</b>	<b>\$ 4,020,332</b>	<b>\$ 3,159,502</b>	<b>\$ 2,130,150</b>	<b>\$ 9,309,984</b>
<b>LIABILITIES</b>				
Accounts payable	\$ 2,384	\$ 5,207	\$ -	\$ 7,591
Deposit payable		25,000		25,000
Due to other funds			67,205	67,205
Deferred revenue	182,491			182,491
<b>Total Liabilities</b>	<b>184,875</b>	<b>30,207</b>	<b>67,205</b>	<b>282,287</b>
<b>FUND BALANCES</b>				
Reserved for:				
Debt service			2,062,945	2,062,945
Low and moderate income housing	3,835,457			3,835,457
Unreserved, undesignated		3,129,295		3,129,295
<b>Total Fund Balances</b>	<b>3,835,457</b>	<b>3,129,295</b>	<b>2,062,945</b>	<b>9,027,697</b>
<b>Total Liabilities and Fund Balances</b>	<b>\$ 4,020,332</b>	<b>\$ 3,159,502</b>	<b>\$ 2,130,150</b>	<b>\$ 9,309,984</b>

See accompanying notes to basic financial statements

**LEMON GROVE COMMUNITY DEVELOPMENT AGENCY  
RECONCILIATION OF THE GOVERNMENTAL FUNDS  
BALANCE SHEET TO THE STATEMENT OF NET ASSETS  
June 30, 2006**

FUND BALANCES - GOVERNMENTAL FUNDS \$ 9,027,697

Amounts reported for Governmental Activities in the Statement of Net Assets are different because of the following:

LONG-TERM ASSETS AND LIABILITIES

The assets and liabilities below are not due and payable in the current period and therefore are not reported in the governmental funds:

Notes receivable and accrued interest on notes receivable which on the governmental funds are offset by a corresponding deferred revenue	182,491
Prepaid items - deferred charges	825,599
Accrued interest on long-term obligations	(330,697)
Bonds payable	(14,910,000)
Advances from the City of Lemon Grove	(4,165,042)

NET ASSETS (DEFICIT) OF GOVERNMENTAL ACTIVITIES \$ (9,369,952)

See accompanying notes to basic financial statements

**LEMON GROVE COMMUNITY DEVELOPMENT AGENCY**  
**STATEMENT OF REVENUES, EXPENDITURES,**  
**AND CHANGES IN FUND BALANCES**  
**GOVERNMENTAL FUNDS**  
**FOR THE FISCAL YEAR ENDED JUNE 30, 2006.**

	Housing Set-Aside Fund	Capital Projects Fund	Debt Service Fund	Totals
<b>REVENUES</b>				
Property tax increment revenue	\$ 462,431	\$ -	\$ 1,849,723	\$ 2,312,154
Use of money and property	137,415	112,387	73,461	323,263
Other revenues	4,803			4,803
<b>Total Revenues</b>	<b>604,649</b>	<b>112,387</b>	<b>1,923,184</b>	<b>2,640,220</b>
<b>EXPENDITURES</b>				
Current:				
Community development	121,076	133,381	140,819	395,276
Debt service:				
Principal retirement			435,000	435,000
Interest and other fiscal charges			966,529	966,529
Pass-through payments			324,019	324,019
<b>Total Expenditures</b>	<b>121,076</b>	<b>133,381</b>	<b>1,866,367</b>	<b>2,120,824</b>
<b>EXCESS OF REVENUES OVER (UNDER) EXPENDITURES</b>	<b>483,573</b>	<b>(20,994)</b>	<b>56,817</b>	<b>519,396</b>
<b>OTHER FINANCING SOURCES (USES):</b>				
Transfers in			80,373	80,373
Transfers (out)	(80,373)			(80,373)
<b>Total Other Financing Sources (Uses)</b>	<b>(80,373)</b>		<b>80,373</b>	
<b>NET CHANGE IN FUND BALANCES</b>	<b>403,200</b>	<b>(20,994)</b>	<b>137,190</b>	<b>519,396</b>
<b>FUND BALANCES, BEGINNING OF FISCAL YEAR</b>	<b>3,432,257</b>	<b>3,150,289</b>	<b>1,925,755</b>	<b>8,508,301</b>
<b>FUND BALANCES, END OF FISCAL YEAR</b>	<b>\$ 3,835,457</b>	<b>\$ 3,129,295</b>	<b>\$ 2,062,945</b>	<b>\$ 9,027,697</b>

See accompanying notes to basic financial statements

**LEMON GROVE COMMUNITY DEVELOPMENT AGENCY  
RECONCILIATION OF THE GOVERNMENTAL FUNDS  
STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN  
FUND BALANCES TO THE STATEMENT OF ACTIVITIES  
For the Fiscal Year Ended June 30, 2006**

NET CHANGE IN FUND BALANCES	\$ 519,396
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Amounts reported for governmental activities in the Statement of Activities  
are different because of the following:

LONG-TERM DEBT PROCEEDS AND PAYMENTS

Repayment of bond principal and note payable are expenditures in the governmental funds, but in the Statement of Net Assets, the repayment reduces long-term liabilities	435,000
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ACCRUAL OF NON-CURRENT ITEMS

The amounts below, included in the Statement of Activities, do not provide or require the use of current financial resources and therefore, are not reported as revenue or expenditures in the governmental funds (net change):

Deferred charges – amortization	(31,909)
Interest payable	<u>5,730</u>

CHANGE IN NET ASSETS OF GOVERNMENTAL ACTIVITIES	<u>\$ 928,217</u>
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See accompanying notes to basic financial statements

**LEMON GROVE COMMUNITY DEVELOPMENT AGENCY  
STATEMENT OF REVENUES, EXPENDITURES,  
AND CHANGES IN FUND BALANCE  
BUDGET AND ACTUAL  
HOUSING SET-ASIDE FUND  
FOR THE FISCAL YEAR ENDED JUNE 30, 2006**

	Original Budget	Final Budget	Actual	Variance with Final Budget Positive (Negative)
<b>REVENUES</b>				
Property tax increment revenue	\$ 300,000	\$ 300,000	\$ 462,431	\$ 162,431
Use of money and property	78,400	78,400	137,415	59,015
Other revenues	178,599	178,599	4,803	(173,796)
<b>Total Revenues</b>	<b>556,999</b>	<b>556,999</b>	<b>604,649</b>	<b>47,650</b>
<b>EXPENDITURES</b>				
Current:				
Community development	222,644	222,644	121,076	101,568
<b>Total Expenditures</b>	<b>222,644</b>	<b>222,644</b>	<b>121,076</b>	<b>101,568</b>
<b>EXCESS OF REVENUES OVER (UNDER) EXPENDITURES</b>	<b>334,355</b>	<b>334,355</b>	<b>483,573</b>	<b>149,218</b>
<b>OTHER FINANCING SOURCES (USES):</b>				
Transfers (out)	(299,615)	(299,615)	(80,373)	219,242
<b>Total Other Financing Sources (Uses)</b>	<b>(299,615)</b>	<b>(299,615)</b>	<b>(80,373)</b>	<b>219,242</b>
<b>NET CHANGE IN FUND BALANCE</b>	<b>34,740</b>	<b>34,740</b>	<b>403,200</b>	<b>368,460</b>
<b>FUND BALANCE, BEGINNING OF FISCAL YEAR</b>	<b>3,432,257</b>	<b>3,432,257</b>	<b>3,432,257</b>	
<b>FUND BALANCE, END OF FISCAL YEAR</b>	<b>\$ 3,466,997</b>	<b>\$ 3,466,997</b>	<b>\$ 3,835,457</b>	<b>\$ 368,460</b>

See accompanying notes to basic financial statements

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**LEMON GROVE COMMUNITY DEVELOPMENT AGENCY**  
**NOTES TO BASIC FINANCIAL STATEMENTS**  
**JUNE 30, 2006**

**NOTE 1 – DESCRIPTION AND SIGNIFICANT ACCOUNTING POLICIES**

**A. Organization and Purpose**

The Lemon Grove Community Development Agency (Agency) was created under the provisions of the Redevelopment Law (California Health and Safety Code) to remove blight in the project area. The Redevelopment Project Area Plan was adopted to provide an improved physical, social, and economic environment in the Project Area. The City Council serves as the governing body of the Agency and the City Administrator serves as the Executive Director.

The Agency is authorized to finance the Plan from various sources, including assistance from the City, the state and federal governments, property tax increments, interest income, and the issuance of Agency notes and bonds.

The Agency is an integral part of the City of Lemon Grove and, accordingly, the accompanying component unit financial statements are included as a component of the basic financial statements prepared by the City. A component unit is a separate governmental unit, agency, or nonprofit corporation which, when combined with all other component units, constitutes the reporting entity as defined in the City's basic financial statements.

**B. Basis of Presentation**

**Government-wide Statements:** The Statement of Net Assets and the Statement of Activities include the financial activities of the overall Agency government. Eliminations have been made to minimize the double counting of internal activities.

The Statement of Activities presents a comparison between direct expenses and program revenues for each function of the Agency's activities. Direct expenses are those that are specifically associated with a program or function and, therefore, are clearly identifiable to a particular function. Program revenues include grants and contributions that are restricted to meeting the operational or capital requirements of a particular program. Revenues that are not classified as program revenues, including all taxes, are presented as general revenues.

**Fund Financial Statements:** The fund financial statements provide information about the Agency's funds. Separate statements for each governmental fund are presented. The emphasis of fund financial statements is on major individual funds, each of which is displayed in a separate column. The Agency considers all of its funds to be major funds.

**C. Major Funds**

GASB Statement No. 34 defines major funds and requires that the Agency's major governmental type funds be identified and presented separately in the fund financial statements. Major funds are defined as funds that have either assets, liabilities, revenues, or expenditures equal to ten percent of their fund-type total and five percent of the grand total. The Agency has determined that all of its funds are major funds.

**LEMON GROVE COMMUNITY DEVELOPMENT AGENCY**  
**NOTES TO BASIC FINANCIAL STATEMENTS**  
**JUNE 30, 2006**

**NOTE 1 – DESCRIPTION AND SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**C. Major Funds (Continued)**

The Agency reported the following major governmental funds in the accompanying financial statements:

**Housing Set-Aside Fund** – This fund accounts for the portion of City and County tax increment funds received for redevelopment related purposes and set-aside for low and moderate income housing.

**Capital Projects Fund** – This fund accounts for redevelopment project capital outlays.

**Debt Service Fund** – This fund accounts for debt service payments on the Agency's long-term debt issues.

**D. Basis of Accounting**

The government-wide financial statements are reported using the economic resources measurement focus and the full accrual basis of accounting. Revenues are recorded when earned and expenses are recorded at the time liabilities are incurred, regardless of when the related cash flows take place.

Governmental funds are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Under this method, revenues are recognized when measurable and available. The Agency considers all revenues reported in the governmental funds to be available if the revenues are collected within sixty days after the fiscal year-end. Expenditures are recorded when the related fund liability is incurred, except for principal and interest on long-term debt, which are recognized as expenditures to the extent they have matured. General capital asset acquisitions are reported as expenditures in governmental funds. Proceeds from long-term debt are reported as other financing sources.

Non-exchange transactions, in which the Agency gives or receives value without directly receiving or giving equal value in exchange, include property taxes, grants, entitlements, and donations. On the accrual basis, revenue from property taxes is recognized in the fiscal year for which the taxes are levied. Revenue from grants, entitlements, and donations is recognized in the fiscal year in which all eligibility requirements have been satisfied.

Under the terms of grant agreements, the Agency funds certain programs by a combination of specific cost-reimbursement grants, categorical block grants, and general revenues. Thus, when program expenses are incurred, there are both restricted and unrestricted net assets available to finance the program. The Agency's policy is to first apply cost-reimbursement grant resources to such programs, followed by general revenues.



**LEMON GROVE COMMUNITY DEVELOPMENT AGENCY**  
**NOTES TO BASIC FINANCIAL STATEMENTS**  
**JUNE 30, 2006**

**NOTE 1 – DESCRIPTION AND SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**E. Accounting Policies**

**Revenue**

The Agency's primary source of revenue is property taxes, referred to in the accompanying component unit financial statements as "incremental property taxes". Property taxes allocated to the Agency are computed in the following manner:

- a. The assessed valuation of all property in the Project Area is determined on the date of adoption of the Redevelopment Plan by a designation of a fiscal year assessment roll.
- b. Property taxes related to any incremental increase in assessed values after the adoption of a Redevelopment Plan are allocated to the Agency; all taxes on the "frozen" assessed valuation of the property are allocated to the City and the other districts receiving taxes from the project area.

The Agency has no power to levy and collect taxes and any legislative property tax reduction would lower the amount of tax revenues that would otherwise be available to pay the principal and interest on bonds or loans from the City. Conversely, any increase in the tax rate or assessed valuation or any elimination of present exemptions would increase the amount of tax revenues that would be available to pay principal and interest on bonds or loans from the City.

The Agency is also authorized to finance the Redevelopment Plan from other sources, including assistance from the City, the State and Federal Government, interest income, and the issuance of Agency debt.

**Property Taxes**

Property taxes in the State of California are administered for all local agencies at the county level, and consist of secured, unsecured, and utility tax rolls. The following is a summary of major policies and practices related to property taxes.

Property Valuations and Tax Levies

The California Community Redevelopment Law provides that assessed valuations of a redevelopment project are, in effect, frozen at the level existing when the redevelopment plan is adopted, and all property taxes produced from this valuation continue to flow to all public agencies levying taxes on property in the project. Taxes produced from any increase in the assessed valuation of a project over the "frozen base" may be allocated to a redevelopment agency to pay or repay costs incurred on behalf of the project. The assessed valuation of a project may be temporarily or permanently reduced below the frozen base as a result of ownership of property by a redevelopment agency pending resale to a developer (temporary), or because a permanent reduction of the assessed valuation will cause a concurrent

**LEMON GROVE COMMUNITY DEVELOPMENT AGENCY**  
**NOTES TO BASIC FINANCIAL STATEMENTS**  
**JUNE 30, 2006**

**NOTE 1 – DESCRIPTION AND SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**E. Accounting Policies (Continued)**

**Property Taxes (Continued)**

reduction of the frozen base so that the production of tax increment income from new development will not be impaired.

Tax Levy Dates

All lien dates attach annually on January 1 preceding the fiscal year for which the taxes are levied. The fiscal year begins July 1 and ends June 30 of the following year. Taxes are levied on both real and unsecured personal property as it exists at that time. Liens against real estate, as well as the tax on personal property, are not relieved by subsequent renewal or change in ownership.

Tax Collections

The county tax collector is responsible for all property tax collections. Taxes and assessments on secured and utility rolls which constitute a lien against the property, may be paid in two installments; the first installment is due on November 1 of the fiscal year and is delinquent if not paid by December 10, the second installment is due on March 1 of the fiscal year and is delinquent if not paid by April 10. Unsecured personal property taxes do not constitute a lien against real property unless the taxes become delinquent. Payment must be made in one installment, which is delinquent if not paid by August 31 of the fiscal year. Significant penalties are imposed by the county for late payments.

**F. Budgets and Budgetary Accounting**

From the effective date of the budget, the amounts stated as proposed expenditures become appropriations to the various Agency departments. The City Council may amend the budget by motion during each fiscal year. The City Manager may transfer funds from one major expenditure category to another within the same department and fund. Any revisions that alter the total expenditures of any fund must be approved by the City Council.

All appropriations lapse at the end of the fiscal year to the extent that they have not been expended. Lease contracts entered into by the Agency are subject to annual review by the City Council; hence, they legally are one year contracts with an option for renewal for another fiscal year.

Budget amounts, as adjusted, reported for the governmental funds of the Agency are adopted on a basis consistent with accounting principles generally accepted in the United States of America.

**LEMON GROVE COMMUNITY DEVELOPMENT AGENCY**  
**NOTES TO BASIC FINANCIAL STATEMENTS**  
**JUNE 30, 2006**

**NOTE 1 – DESCRIPTION AND SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**G. Long-term Obligations**

In the government-wide financial statements, long-term debts and other long-term obligations are reported as liabilities in the Statement of Net Assets. Bond premiums and discounts, and issuance costs, are deferred and amortized over the life of the bonds.

**H. Use of Estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

**I. New Accounting Pronouncements**

*Governmental Accounting Standards Board Statement No. 46*

For fiscal year June 30, 2006, the Agency implemented Governmental Accounting Standard Board Statement No. 46, "*Net assets Restricted by Enabling Legislation – an amendment of GASB Statement No. 34*". This Statement is effective for fiscal periods beginning after June 15, 2005. This Statement requires that limitations on the use of net assets imposed by enabling legislation be reported as restricted net assets. A legally enforceable enabling legislation restriction in one that a party external to the Agency – such as citizens, public interest groups, or the judiciary – can compel a government to honor. Implementation of GASB Statement No. 46 did not have an impact on the Agency's financial statements for the fiscal year ended June 30, 2006, but required additional disclosure related to restricted net assets.

**NOTE 2 – RECONCILIATION OF GOVERNMENT-WIDE AND FUND FINANCIAL STATEMENTS**

**1. Explanation of certain differences between the Governmental Funds Balance Sheet and the Government-wide Statement of Net Assets**

The Governmental Funds Balance Sheet includes a reconciliation between fund balance-total governmental funds and net assets (deficit) of governmental activities as reported in the Government-wide Statement of Net Assets.

Deferred charges are not available to pay for current-period expenditures and therefore are not reported as governmental fund assets. These deferred charges net of accumulated amortization are as follows:

Deferred bond issuance costs, net of amortization of \$151,854	\$ <u>825,599</u>
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**LEMON GROVE COMMUNITY DEVELOPMENT AGENCY**  
**NOTES TO BASIC FINANCIAL STATEMENTS**  
**JUNE 30, 2006**

**NOTE 2 – RECONCILIATION OF GOVERNMENT-WIDE AND FUND FINANCIAL STATEMENTS (Continued)**

**1. Explanation of certain differences between the Governmental Funds Balance Sheet and the Government-wide Statement of Net Assets (Continued)**

Certain liabilities, including bonds payable and interest on advances and bonds, are not due and payable in the current period and therefore, are not reported in the funds. These liabilities are as follows:

1998 Tax allocation refunding bonds	\$ (8,730,000)
2004 Tax allocation bonds	(6,180,000)
Advances from the City of Lemon Grove	(4,165,042)
Accrued interest payable	(330,697)
	<u>\$ (19,405,739)</u>

Notes and interest receivable are offset with deferred revenue in the governmental funds but not in the Statement of Net Assets. This asset is as follows:

Notes receivable and accrued interest on notes receivable	<u>\$ 182,491</u>
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**2. Explanation of certain differences between the Governmental Funds Statement of Revenues, Expenditures, and Changes in Fund Balances and the Government-wide Statement of Activities**

The Governmental Funds Statement of Revenues, Expenditures, and Changes in Fund Balances includes the reconciliation between the net changes in fund balances of the total governmental funds and change in net assets of the governmental activities as reported in the Government-wide Statement of Activities. One element of that reconciliation states that "The issuance of long-term debt provides current financial resources to governmental funds, while the repayment of the principal of long-term debt consumes the current financial resources of the governmental funds. Neither transaction, however, has any effect on net assets". The details of this adjustment are as follows:

Debt principal repayment:	
1998 Tax allocation refunding bonds	\$ 185,000
2004 Tax allocation bonds	150,000
City loans and advances	100,000
Amortization of issuance costs	(31,909)
Change in accrued interest payable	<u>5,730</u>
Total long-term debt adjustment	<u>\$ 408,821</u>

**LEMON GROVE COMMUNITY DEVELOPMENT AGENCY**  
**NOTES TO BASIC FINANCIAL STATEMENTS**  
**JUNE 30, 2006**

**NOTE 3 – CASH AND INVESTMENTS**

Cash and investments as of June 30, 2006 are classified in the accompanying financial statements as follows:

Statement of net assets:	
Cash and investments	\$ 7,840,451
Restricted cash and investments with fiscal agents	<u>1,069,479</u>
Total cash and investments	<u>\$ 8,909,930</u>

Cash and investments as of June 30, 2006 consist of the following:

Deposits with financial institutions	\$ (1,953)
Investments	<u>8,911,883</u>
Total cash and investments	<u>\$ 8,909,930</u>

**A. Investments Authorized by the California Government Code and the Agency's Investment Policy**

The table below identifies the **investment types** that are authorized for the Lemon Grove Community Development Agency (Agency) by the California Government Code (or the Agency's investment policy, where more restrictive). The table also identifies certain provisions of the California Government Code (or the Agency's investment policy, where more restrictive) that address **interest rate risk**, **credit risk**, and **concentration of credit risk**. This table does not address investments of debt proceeds held by bond trustee that are governed by the provisions of debt agreements of the Agency, rather than the general provisions of the California government Code or the Agency's investment policy.

<u>Authorized Investment Type</u>	<u>Maximum Maturity</u>	<u>Maximum Percentage of Portfolio</u>	<u>Maximum Investment in One Issuer</u>
Local Agency Investment Fund (State Pool)	N/A	None	None
U.S. Treasury Obligations	N/A	None	None
U.S. Government Agency Issues	N/A	None	None
Insured Passbook on Demand Deposits with Banks and Savings and Loans	N/A	None	\$100,000
Certificates of Deposit	1 year	None	\$100,000
Bankers Acceptances			
Commercial Paper	N/A	None	None
Mutual Funds (must be comprised of eligible securities permitted under this policy)	N/A	None	None
Money Market Funds (must be comprised of eligible securities permitted under this policy)	N/A	None	None

The investment policy allows for the above investments which have equal safety and liquidity as all other allowed investments. Maturity depends on the cash needs of the Agency.

**LEMON GROVE COMMUNITY DEVELOPMENT AGENCY**  
**NOTES TO BASIC FINANCIAL STATEMENTS**  
**JUNE 30, 2006**

**NOTE 3 - CASH AND INVESTMENTS (Continued)**

**B. Investments Authorized by Debt Agreements**

Investment of debt proceeds held by bond trustees are governed by provisions of the debt agreements, rather than the general provisions of the California Government Code or the Agency's investment policy. The table below identifies the **Investment types** that are authorized for investments held by bond trustee. The table also identifies certain provisions of these debt agreements that address **interest rate risk, credit risk, and concentration of credit risk.**

<u>Authorized Investment Type</u>	<u>Maximum Maturity</u>	<u>Maximum Percentage of Portfolio</u>	<u>Maximum Investment in One Issuer</u>
Local Agency Investment Fund (State Pool)	N/A	None	None
U.S. Treasury Obligations	N/A	None	None
U.S. Government Agency Issues	N/A	None	None
Insured Passbook on Demand Deposits with Banks and Savings and Loans	N/A	None	\$100,000
Certificates of Deposit	1 year	None	\$100,000
Bankers Acceptances			
Commercial Paper	N/A	None	None
Mutual Funds (must be comprised of eligible securities permitted under this policy)	N/A	None	None
Money Market Funds (must be comprised of eligible securities permitted under this policy)	N/A	None	None

The investment policy allows for the above investments which have equal safety and liquidity as all other allowed investments. Maturity depends on the cash needs of the Agency.

**C. Disclosures Relating to Interest Rate Risk**

Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value to changes in market interest rates. One of the ways that the Agency manages its exposure to interest rate risk is by purchasing a combination of shorter term and longer term investments and by timing cash flows from maturities so that a portion of the portfolio is maturing or coming close to maturity evenly over time as necessary to provide the cash flow and liquidity needed for operations.

Information about the sensitivity of the fair values of the Agency's investments (including investments held by bond trustee) to market interest rate fluctuations is provided by the following table that shows the distribution of the Agency's investments by maturity:

<u>Investment Type</u>	<u>Totals</u>	<u>Remaining maturity (in Months)</u>			
		<u>12 Months or Less</u>	<u>13 to 24 Months</u>	<u>25-60 Months</u>	<u>More Than 60 Months</u>
State Investment Pool	\$ 7,842,410	\$ 7,842,410	\$ -	\$ -	\$ -
Held by Bond Trustees:					
U.S. Treasury Money Market	1,069,473	1,069,473			
	<u>\$ 8,911,883</u>	<u>\$ 8,911,883</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

**LEMON GROVE COMMUNITY DEVELOPMENT AGENCY**  
**NOTES TO BASIC FINANCIAL STATEMENTS**  
**JUNE 30, 2006**

**NOTE 3 - CASH AND INVESTMENTS (Continued)**

**D. Investments with Fair Values Highly Sensitive to Interest Rate Fluctuations**

The Agency has no investments (including investments held by bond trustees) that are highly sensitive to interest rate fluctuations (to a greater degree than already indicated in the information provided above).

**E. Disclosures Relating to Credit Risk**

Generally, credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization. Presented below is the minimum rating required by (where applicable) the California Government Code, the Agency's investment policy, or debt agreements, and the actual rating as of fiscal year end for each investment type.

Investment Type	Amount	Minimum Legal Rating	Exempt From Disclosure	Rating as of Fiscal Year End			
				AAA	AA	A	Not Rated
State Investment Pool	\$ 7,842,410	N/A	\$ -	\$ -	\$ -	\$ -	\$ 7,842,410
Held by bond trustees:							
U.S. Treasury Money Market	1,069,473	N/A					1,069,473
Totals	<u>\$ 8,911,883</u>		<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 8,911,883</u>

**F. Concentration of Credit Risk**

The investment policy of the Agency contains limitations on the amount that can be invested in any one issuer. The Agency has no investments in any one issuer (other than U.S. Treasury securities, mutual funds, and external investment pools) that represent 5% or more of total Agency investments.

**G. Custodial Credit Risk**

Custodial credit risk for *deposits* is the risk that, in the event of the failure of a depository financial institution, a government will not be able to recover its deposits or will not be able to recover collateral securities that are in the possession of an outside party. The custodial credit risk for *investments* is the risk that, in the event of the failure of the counterparty (e.g. broker-dealer) to a transaction, a government will not be able to recover the value of its investment or collateral securities that are in the possession of another party. The California Government Code and the Agency's investment policy do not contain legal or policy requirements that would limit the exposure to custodial credit risk for deposits or investments, other than the following provision for deposits; The California Government Code requires that a financial institution secure deposits made by state or local governmental units by pledging securities in an undivided collateral pool held by a depository regulated under state law (unless so waived by the government unit). The fair value of the pledged securities in the collateral pool must equal at least 110% of the total amount deposited by the public agencies. California law also allows financial institutions to secure Agency deposits by pledging first trust deed mortgage notes having a value of 150% of the secured public deposits.

**LEMON GROVE COMMUNITY DEVELOPMENT AGENCY**  
**NOTES TO BASIC FINANCIAL STATEMENTS**  
**JUNE 30, 2006**

**NOTE 3 - CASH AND INVESTMENTS (Continued)**

**G. Custodial Credit Risk (Continued)**

As of June 30, 2006, Agency investments in the following investment types were held by the same broker-dealer (counterparty) that was used by the Agency to buy the securities:

<u>Investment Type</u>	<u>Reported Amount</u>
U.S. Treasury Money Market	\$ 1,069,473

Cash balance in banks (\$3,548 as of June 30, 2006) is insured up to \$100,000 by the Federal Depository Insurance Corporation. All cash held by the financial institution is fully insured or collateralized.

**H. Investment in State Investment Pool**

The Agency is a voluntary participant in the Local Agency Investment Fund (LAIF) that is regulated by the California Government Code under the oversight of the Treasurer of the State of California. The fair value of the Agency's investment in this pool is reported in the accompanying financial statements at amounts based upon the Agency's pro-rata share of the fair value provided by LAIF for the entire LAIF portfolio (in relation to the amortized cost of that portfolio). The balance available for withdrawal is based on the accounting records maintained by LAIF, which are recorded on an amortized cost basis.

**NOTE 4 - NOTES RECEIVABLE**

Notes receivable in the amount of \$182,491 consist of mortgage loans for housing and property rehabilitation and construction.

**NOTE 5 - DEFERRED CHARGES**

Deferred charges consist of issuance costs and discounts for debt issues. The total costs deferred as a result of the issuance of the 1998 tax allocation refunding bonds were \$427,963. The amortization period is 364 months. Accumulated amortization as of June 30, 2006 was \$115,221 with amortization expense for the fiscal year of \$14,109. The total costs deferred as a result of the issuance of the 2004 tax allocation bonds were \$549,490. The amortization period is 360 months. Accumulated amortization as of June 30, 2006 was \$36,633 with amortization expense for the fiscal year of \$17,800.



**LEMON GROVE COMMUNITY DEVELOPMENT AGENCY**  
**NOTES TO BASIC FINANCIAL STATEMENTS**  
**JUNE 30, 2006**

**NOTE 6 – LONG-TERM OBLIGATIONS**

The following is a summary of long-term obligation transactions of the Agency for the fiscal year ended June 30, 2006:

	July 1, 2005			June 30, 2006	
	Balance	Additions	Reductions	Balance	Due Within One Year
1998 Tax Allocation Refunding Bonds	\$ 8,915,000	\$ -	\$ 185,000	\$ 8,730,000	\$ 195,000
2004 Tax Allocation Bonds	6,330,000		150,000	6,180,000	150,000
Advances from the City of Lemon Grove	4,265,042		100,000	4,165,042	
Total Long-Term Obligation	<u>\$ 19,510,042</u>	<u>\$ -</u>	<u>\$ 435,000</u>	<u>\$ 19,075,042</u>	<u>\$ 345,000</u>

The Agency normally uses long-term Tax Allocation Bonds to finance projects or purchase assets, which will have useful lives equal to or greater than the related debt. The Agency's Bond transactions and balances are summarized below.

**A. 1998 Tax Allocation Refunding Bonds**

In May 1998, the Agency issued \$9,420,000 in tax allocation bonds with interest rates varying from 5.00% to 5.75% to advance refund \$7,895,000 of outstanding Series 1992 Lemon Grove Redevelopment Project Tax Allocation Bonds with interest rates ranging from 5.00% to 6.90%. The refunding bonds were also issued to retire Disposition and Developer Agreements with Coral Ford and Land Grant Development Company. The net proceeds (after original issue discount of \$180,805 and underwriter fees and other issue costs of \$198,402) were deposited into an escrow fund. Of the proceeds, \$672,338 was set aside to immediately retire the Disposition and Development Agreements. Pursuant to the escrow agreement, \$8,307,194 was deposited into the Lemon Grove Community Development Agency 1998 Escrow Fund and these bonds were redeemed in full on August 1, 2002. 1998 bonds outstanding at June 30, 2006 were \$8,730,000.

Agency tax increment revenue is pledged for the repayment of these bonds. Interest is payable semi-annually each August 1 and February 1 through 2028.

The scheduled annual minimum debt service requirements at June 30, 2006 are as follows:

Fiscal Year Ended June 30,	Principal	Interest	Total
2007	\$ 195,000	\$ 493,123	\$ 688,123
2008	205,000	483,020	688,020
2009	215,000	472,203	687,203
2010	225,000	460,144	685,144
2011	240,000	446,775	686,775
2012-2016	1,420,000	2,004,163	3,424,163
2017-2021	1,880,000	1,532,950	3,412,950
2022-2026	2,490,000	908,500	3,398,500
2027-2029	1,860,000	164,451	2,024,451
Totals	<u>\$ 8,730,000</u>	<u>\$ 6,965,329</u>	<u>\$ 15,695,329</u>

**LEMON GROVE COMMUNITY DEVELOPMENT AGENCY**  
**NOTES TO BASIC FINANCIAL STATEMENTS**  
**JUNE 30, 2006**

**NOTE 6 – LONG-TERM OBLIGATIONS (Continued)**

**B. 2004 Tax Allocation Bonds**

On August 1, 2004, the Agency issued \$6,330,000 of Tax Allocation Bonds bearing interest between 2.25% to 5.40% and payable semi-annually on February 1 and August 1. The Bonds mature annually at various amounts through August 1, 2034. The bonds are payable from and secured by incremented tax revenues (Pledged Tax Revenues). The Bond proceeds are to be used to finance certain projects with the Agency's project area including low and moderate income housing. Bonds outstanding at June 30, 2006 were \$6,180,000.

The scheduled annual minimum debt service requirements at June 30, 2006 are as follows:

Fiscal Year Ended June 30,	Principal	Interest	Total
2007	\$ 150,000	\$ 293,426	\$ 443,426
2008	210,000	288,251	498,251
2009	60,000	284,501	344,501
2010	60,000	282,746	342,746
2011	60,000	280,804	340,804
2012-2016	355,000	1,365,790	1,720,790
2017-2021	435,000	1,281,221	1,716,221
2022-2026	555,000	1,159,306	1,714,306
2027-2031	2,120,000	931,924	3,051,924
2032-2035	2,175,000	175,855	2,350,855
Totals	<u>\$ 6,180,000</u>	<u>\$ 6,343,824</u>	<u>\$ 12,523,824</u>

**C. Advances from City of Lemon Grove**

The advances payable to the City of Lemon Grove have no stated interest rate. Interest expense is computed monthly using the rate currently being paid by the Local Agency Investment Fund. This resulted in an average rate of 3.86 % for the fiscal year resulting in a total interest expense of \$160,897. This loan will be repaid based on a schedule to be agreed upon by the City and the Agency. There is no future minimum debt service requirement as repayment will be made when funds are available.

**NOTE 7 – INTERFUND TRANSACTIONS**

**A. Current Interfund Balances**

Current interfund balances decrease in the normal course of business and are expected to be repaid shortly after the end of the fiscal year. The following presents a summary of current interfund balances at June 30, 2006.

**LEMON GROVE COMMUNITY DEVELOPMENT AGENCY**  
**NOTES TO BASIC FINANCIAL STATEMENTS**  
**JUNE 30, 2006**

**NOTE 7 – INTERFUND TRANSACTIONS (Continued)**

**A. Current Interfund Balances (Continued)**

	<u>Due from Other Funds</u>	<u>Due to Other Funds</u>
Housing Set-Aside Fund	\$ 24,840	\$ -
Capital Projects Fund	42,365	
Debt Service Fund		67,205
Total	<u>\$ 67,205</u>	<u>\$ 67,205</u>

**B. Transfers Between Funds**

With Council approval, resources may be transferred from one fund to another. The purpose of the majority of transfers is to reimburse a fund that has made an expenditure on behalf of another fund. Transfers totaled \$80,373 in the fund financial statements.

	<u>Transfers In</u>	<u>Transfers Out</u>
Housing Set-Aside Fund	\$ -	\$ 80,373
Debt Service Fund	80,373	
Total	<u>\$ 80,373</u>	<u>\$ 80,373</u>

These balances have been eliminated in the Government-wide Statement of Assets and Statement of Activities.

**NOTE 8 – NET ASSETS AND FUND BALANCES**

GASB Statement No. 34 adds the concept of Net Assets, which is measured on the full accrual basis, to the concept of Fund Balance, which is measured on the modified accrual basis.

**A. Net Assets**

Net Assets are divided into three captions under GASB Statement No. 34. These captions apply only to Net Assets as determined at the Government-wide level, and are described below:

*Invested in Capital Assets, net of related debt* describes the portion of net assets, which is represented by the current net book value of the Agency's capital assets, less the outstanding balance of any debt issued to finance these assets. As of June 30, 2006, since Agency's debt is more than its net capital assets, net assets are not recorded in this caption.

*Restricted* describes the portion of Net Assets which is restricted as to use by the terms and conditions of agreements with outside parties, governmental regulations, laws, or other restrictions which the Agency cannot unilaterally alter. These principally include developer fees received for use on capital projects, debt service requirements, and redevelopment funds restricted to low and moderate income housing purposes.

*Unrestricted* describes the portion of Net Assets which is not restricted as to use.

**LEMON GROVE COMMUNITY DEVELOPMENT AGENCY**  
**NOTES TO BASIC FINANCIAL STATEMENTS**  
**JUNE 30, 2006**

**NOTE 8 – NET ASSETS AND FUND BALANCES (Continued)**

**A. Net Assets (Continued)**

The government-wide statement of net assets reports \$5,750,196 of restricted net assets, of which \$5,567,705 is restricted by enabling legislation.

**B. Fund Balances**

Fund balances consist of reserved and unreserved amounts. Reserved fund balances represent that portion of fund balance which is legally segregated for low and moderate income housing projects as required by the California Health and Safety Code or debt service expenditures as required under bond indenture.

**NOTE 9 –FINANCIAL CONDITION**

The Agency has a deficit in net assets of \$9,369,952 at June 30, 2006. The Agency projects that future resources will be sufficient to pay long-term obligations as they become due.

## **OTHER SUPPLEMENTAL INFORMATION**

**LEMON GROVE COMMUNITY DEVELOPMENT AGENCY  
SCHEDULE OF REVENUES, EXPENDITURES,  
AND CHANGES IN FUND BALANCE  
BUDGET AND ACTUAL  
CAPITAL PROJECTS FUND  
FOR THE FISCAL YEAR ENDED JUNE 30, 2006**

	Final Budget	Actual	Variance with Final Budget Positive (Negative)
REVENUES			
Use of money and property	\$ -	\$ 112,387	\$ 112,387
Total Revenues		112,387	112,387
EXPENDITURES			
Current:			
Community development	190,648	133,381	57,267
Total Expenditures	190,648	133,381	57,267
EXCESS OF REVENUES OVER (UNDER) EXPENDITURES	(190,648)	(20,994)	169,654
FUND BALANCE, BEGINNING OF FISCAL YEAR	3,150,289	3,150,289	
FUND BALANCE, END OF FISCAL YEAR	\$ 2,959,641	\$ 3,129,295	\$ 169,654

**LEMON GROVE COMMUNITY DEVELOPMENT AGENCY**  
**SCHEDULE OF REVENUES, EXPENDITURES,**  
**AND CHANGES IN FUND BALANCE**  
**BUDGET AND ACTUAL**  
**DEBT SERVICE FUND**  
**FOR THE FISCAL YEAR ENDED JUNE 30, 2006**

	Final Budget	Actual	Variance with Final Budget Positive (Negative)
REVENUES			
Property tax increment revenue	\$ 1,010,000	\$ 1,849,723	\$ 839,723
Use of money and property	10,000	73,461	63,461
Total Revenues	<u>1,020,000</u>	<u>1,923,184</u>	<u>903,184</u>
EXPENDITURES			
Current:			
Community development	178,599	140,819	37,780
Debt Service:			
Principal retirement	100,000	435,000	(335,000)
Interest and other fiscal charges	1,259,920	966,529	293,391
Bond issuance costs	3,000	3,000	3,000
Pass-through payments	83,000	324,019	(241,019)
Total Expenditures	<u>1,624,519</u>	<u>1,866,367</u>	<u>(241,848)</u>
EXCESS OF REVENUES OVER (UNDER) EXPENDITURES	<u>(604,519)</u>	<u>56,817</u>	<u>661,336</u>
OTHER FINANCING SOURCES (USES)			
Transfers in	<u>299,615</u>	<u>80,373</u>	<u>(219,242)</u>
Total Other Financing Sources (Uses)	<u>299,615</u>	<u>80,373</u>	<u>(219,242)</u>
NET CHANGE IN FUND BALANCE	(304,904)	137,190	442,094
FUND BALANCE, BEGINNING OF FISCAL YEAR	<u>1,925,755</u>	<u>1,925,755</u>	
FUND BALANCE, END OF FISCAL YEAR	<u>\$ 1,620,851</u>	<u>\$ 2,062,945</u>	<u>\$ 442,094</u>

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CALIFORNIA ASSOCIATION OF  
SCHOOL BUSINESS OFFICIALS

OFFICES:

BEVERLY HILLS, CALIFORNIA  
SANTA MARIA, CALIFORNIA

**REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE  
AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED  
IN ACCORDANCE WITH  
GOVERNMENT AUDITING STANDARDS**

Board of Directors  
Lemon Grove Community Development Agency  
Lemon Grove, California

We have audited the financial statements of the governmental funds and each major fund of the Lemon Grove Community Development Agency as of and for the fiscal year ended June 30, 2006 which collectively comprise the Agency's basic financial statements, and have issued our report thereon dated October 19, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Lemon Grove Community Development Agency's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the financial statements of the Lemon Grove Community Development Agency are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. Such provisions include those provisions of laws and regulations identified in the *Guidelines for Compliance Audits of California Redevelopment Agencies*, issued by the State Controller's Office, Division of Accounting and Reporting. However, providing an opinion on compliance with those provisions was not an objective of our



audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information of the audit committee, management, and the State Controller and is not intended to be and should not be used by anyone other than these specified parties.

*Moss, Levy & Hartzheim*

Moss, Levy & Hartzheim, LLP  
Beverly Hills, California  
October 19, 2006